closing date for comments. A report summarizing each substantive public contact with FAA personnel concerned with this rulemaking will be filed in the docket.

Availability of NPRM's

An electronic copy of this document may be downloaded through the Internet at *http://dms.dot.gov.* Recently published rulemaking documents can also be accessed through the FAA's web page at *http://www.faa.gov* or the **Federal Register**'s web page at *http://www.gpoaccess.gov/fr/index.html.*

You may review the public docket containing the proposal, any comments received, and any final disposition in person in the Dockets Office (see **ADDRESSES** section for address and phone number) between 9 a.m. and 5 p.m., Monday through Friday, except Federal holidays. An informal docket may also be examined during normal business hours at the office of the Regional Air Traffic Division, Federal Aviation Administration, 2601 Meacham Blvd; Fort Worth, TX 76193–0500.

Persons interested in being placed on a mailing list for future NPRM's should contact the FAA's Office of Rulemaking, (202) 267–9677, for a copy of Advisory Circular No. 11–2A, Notice of Proposed Rulemaking Distribution System, which describes the application procedure.

History

On June 16, 2006, the FAA published an NPRM in the **Federal Register** to establish 16 VOR Federal Airways (V–65, V–176, V–383, V–396, V–406, V–410, V–414, V–416, V–418, V–426, V–467, V–486, V–542, V–584, V–586, and V–609); modify 13 VOR Federal Airways (V–14, V–26, V–40, V–72, V–75, V–90, V–96, V–103, V–116, V–133, V–297, V–435, and V–526); and revoke one VOR Federal Airway (V–42) (71 FR 34854). Interested parties were invited to participate in this rulemaking effort by submitting written comments on the proposal. No comments were received objecting to the proposal.

On January 18, 2007, the FAA published in the **Federal Register** a final rule (72 FR 2182) taking action on all of the above proposed airway establishments, modifications and revocations except V–65 and V–133. Action on V–65 was deferred because the Sandusky VOR was out of service. Establishment of V–65 is being taken under separate rulemaking. Action on V–133 was deferred because the original routing proposed in the NPRM did not pass flight check. This SNPRM proposes an alternative routing for V–133 that has already passed flight check.

The Proposal

The FAA is proposing to amend Title 14 Code of Federal Regulations (14 CFR) part 71 to modify V–133 over the East Central United States. This action is proposed as part of MASE to enhance safety and to facilitate the more flexible and efficient use of the navigable airspace. Further, this action would enhance the management of aircraft operations within the Chicago, Cleveland, and Indianapolis Air Route Traffic Control Centers' areas of responsibility.

VOR Federal Airways are published in paragraph 6010 of FAA Order 7400.9P, dated September 1, 2006, and effective September 15, 2006, which is incorporated by reference in 14 CFR 71.1. The VOR Federal Airways listed in this document would be published subsequently in the Order.

The FAA has determined that this proposed regulation only involves an established body of technical regulations for which frequent and routine amendments are necessary to keep them operationally current. Therefore, this proposed regulation: (1) Is not a ''significant regulatory action'' under Executive Order 12866; (2) is not a ''significant rule'' under Department of Transportation (DOT) Regulatory Policies and Procedures (44 FR 11034; February 26, 1979); and (3) does not warrant preparation of a regulatory evaluation as the anticipated impact is so minimal. Since this is a routine matter that will only affect air traffic procedures and air navigation, it is certified that this proposed rule, when promulgated, will not have a significant economic impact on a substantial number of small entities under the criteria of the Regulatory Flexibility Act.

Environmental Review

The FAA has determined that this action qualifies for categorical exclusion under the National Environment Policy Act in accordance with 311a and 311b., FAA Order 1050.1E, ''Environmental Impacts: Policies and Procedures''. This airspace action is not expected to cause any potentially significant environment impacts, and no extraordinary circumstances exist that warrant preparation of environmental assessment.

List of Subjects in 14 CFR Part 71

Airspace, Incorporation by reference, Navigation (air).

The Proposed Amendment

In consideration of the foregoing, the Federal Aviation Administration proposes to amend 14 CFR part 71 as follows:

PART 71—DESIGNATION OF CLASS A, B, C, D, AND E AIRSPACE AREAS; AIR TRAFFIC SERVICE ROUTES; AND REPORTING POINTS

1. The authority citation for part 71 continues to read as follows:

Authority: 49 U.S.C. 106(g), 40103, 40113, 40120; E.O. 10854, 24 FR 9565, 3 CFR, 1959–1963 Comp., p. 389.

§ 71.1 [Amended]

2. The incorporation by reference in 14 CFR 71.1 of FAA Order 7400.9P, Airspace Designations and Reporting Points, dated September 1, 2006, and effective September 15, 2006, is amended as follows:

Paragraph 6010 VOR Federal Airways

* * * * *

V–133 [Revised]

From INT Charlotte, NC, 305° and Barretts Mountain, NC, 197° radials; Barrets Mountain; Charleston, WV; Zanesville, OH; Tiverton, OH; Mansfield, OH; Sandusky, OH; INT Sandusky 342°(T)/346°(M) and Detroit, MI 138°(T)/144°(M) radials; Detroit; Salem, MI; INT Salem 346° and Saginaw, MI 160° radials; Saginaw; Traverse City, MI; Escanaba, MI; Sawyer, MI; Houghton, MI; Thunder Bay, ON, Canada; International Falls, MN; to Red Lake, ON, Canada. The airspace within Canada is excluded.

* * * * *

Issued in Washington, DC, on June 6, 2007.

Kenneth McElroy,

Acting Manager, Airspace and Rules Group.

[FR Doc. E7–11537 Filed 6–14–07; 8:45 am]

BILLING CODE 4910–13–P

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG–147171–05]

RIN 1545–BF34

Deductions for Entertainment Use of Business Aircraft

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations relating to the use of business aircraft for entertainment. These proposed regulations affect taxpayers that deduct expenses for entertainment, amusement, or recreation provided to specified individuals. This document also provides notice of a public hearing on these proposed regulations. The proposed regulations reflect amendments under the American

Jobs Creation Act of 2004 (AJCA) and the Gulf Opportunity Zone Act of 2005 (GOZA).

DATES: Written comments must be received by September 13, 2007. Requests to speak and outlines of topics to be discussed at the public hearing scheduled for October 25, 2007, at 10 a.m., must be received by October 4, 2007.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–147171–05), room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–147171–05), courier's desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC. Alternatively, taxpayers may submit electronic comments via the internet at the Federal eRulemaking Portal at *www.regulations.gov* (IRS–REG–147171–05). The public hearing will be held in the auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations under section 274, Michael A. Nixon of the Office of Associate Chief Counsel (Income Tax & Accounting), (202) 622–4930; concerning the regulations under section 61, Lynne A. Camillo of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt & Government Entities), (202) 622–6040 (not toll-free numbers); concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Richard Hurst at *Richard.A.Hurst@irscounsel.treas.gov.*

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed regulations under section 274(e)(2) of the Internal Revenue Code (Code). Section 274(e)(2) was amended by section 907 of the AJCA, Public Law 108–357, and by section 403(mm) of the GOZA, Public Law 109–135. Both amendments are effective for certain expenses incurred after October 22, 2004. On May 27, 2005, the IRS and Treasury Department issued Notice 2005–45 (2005–24 IRB 1228) providing interim guidance on amended section 274(e)(2) and inviting comments. Notice 2005–45 is effective for expenses incurred after June 30, 2005. Commentators submitted written and electronic comments responding to Notice 2005–45. The IRS and Treasury Department have reviewed and considered all the comments in the process of preparing these proposed regulations. See § 601.601(d)(2)(ii)(*b*) of this chapter.

Generally, section 162(a) allows as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. Under section 274(a)(1)(A), no deduction is allowed for an activity generally considered to be entertainment, amusement, or recreation, unless the taxpayer establishes that the activity is directly related to or (in certain cases) associated with the active conduct of the taxpayer's trade or business.

Section 1.274–2(b)(1) of the Income Tax Regulations provides that entertainment means any activity of a type generally considered to constitute entertainment, amusement, or recreation, such as entertaining at night clubs, cocktail lounges, theaters, country clubs, golf and athletic clubs, sporting events, and on hunting, fishing, vacation and similar trips. Similar activities relating solely to the taxpayer's family also may constitute entertainment. Entertainment may include an activity that satisfies the personal, living, or family needs of an individual, such as providing food and beverages or a hotel suite to a business customer or the customer's family. Entertainment does not include activities, however, that are clearly not regarded as constituting entertainment, such as the provision of supper money by an employer to an employee working overtime, the maintenance of a hotel room by an employer for lodging of an employee while in business travel status, or the use of an automobile in the active conduct of a trade or business even though also used for routine personal purposes such as commuting to and from work. Under § 1.274–2(b)(1)(ii), an objective test is used to determine whether an activity is of a type generally considered to constitute entertainment.

Section 274(e) provides exceptions to the general disallowance provisions of section 274(a). Prior to amendment by the AJCA, section 274(e)(2) excepted expenses from section 274(a) ''to the extent that the expenses are treated by the taxpayer'' as compensation to the employee. Under prior law, section 274(e)(9) similarly excepted expenses to the extent that the expenses are treated by the taxpayer as income to persons who are not employees.

Section 274(o) provides that the Secretary shall prescribe regulations necessary to carry out the purposes of the section.

Generally, § 1.61–21(b)(1) requires an employee to include in gross income the fair market value of a fringe benefit, such as an entertainment flight, after subtracting amounts paid, by or on behalf of the employee, for the fringe benefit, as well as amounts excluded from income by another section of the Code. If an employee takes a personal flight on an employer's aircraft, and the employer also provides a pilot, the general rule under § 1.61–21(b)(6) is that the fair market value of the flight is equal to the amount that an individual would have to pay in an arm's-length transaction to charter the same or a comparable piloted aircraft for that period for the same or a comparable flight. If the employer does not provide a pilot, the general rule under § 1.61–21(b)(7) is that the fair market value of the flight is equal to the amount that an individual would have to pay in an arm's-length transaction to rent a comparable aircraft for that period in the geographic area in which the aircraft is used. The regulations do not permit valuation of a flight by reference to the employer's costs.

As an alternative to the general valuation rules just described, § 1.61–21(g) provides that an employee's personal flights on an employer's aircraft may be valued using an optional special valuation rule, the non-commercial flight valuation rule. In order to use the non-commercial flight valuation rule, applying the applicable aircraft multiple from § 1.61–21(g)(7), it is necessary to know the weight of the employer's aircraft, the number of miles for the flight being valued, and whether the employee receiving the benefit is a control employee within the meaning of § 1.61–21(g)(8) or (9). The value of an employee's personal use of a company aircraft is computed by multiplying the Standard Industry Fare Level (SIFL) by the terminal charge to arrive at the value of the flight (the SIFL formula). SIFL is a cents-per-mile factor that, taken with the aircraft multiple and the terminal charge, is intended to approximate coach and first class fares on commercial aircraft.

The consistency rule set forth in § 1.61–21(g)(14)(i) provides that a taxpayer who uses the SIFL formula in a calendar year to value any flight provided to an employee must use the SIFL formula to value all flights provided to employees during that calendar year. Notice 2005–45 advised taxpayers that the consistency rule in the regulations would be amended to permit taxpayers to value the entertainment use of aircraft by specified individuals (within the meaning of section 274(e)(2)(B)) under

the fair market value rules of § 1.61–21(b) but continue to value flights for other employees and for specified individuals not traveling for entertainment purposes using the SIFL formula.

In *Sutherland Lumber-Southwest, Inc.* v. *Comm'r*, 114 T.C. 197 (2000), *aff'd* 255 F.3d 495 (8th Cir. 2001), *acq.* 2002–1 CB xvii, the Tax Court held that the amount a taxpayer may deduct for the cost of entertainment-related flights under the section 274(e)(2) exception is not limited to the amount included in the income of the employees and corporate officers who took the flights. Rather, the court held that a taxpayer may deduct the full cost of an employee's or officer's non-business flight on the taxpayer's aircraft if the taxpayer includes in the recipient's income the value of the flights computed under the non-commercial flight valuation rule of § 1.61–21. As a result, a deduction greater than the amount included in the recipient's income was allowable.

Section 907 of the AJCA was intended to overturn *Sutherland Lumber* in certain cases. H. Conf. Rept. No. 108–755, at 798 (2004). Specifically, as amended by the AJCA, the section 274(e)(2) and (9) exceptions to the section 274(a) disallowance apply in the case of a specified individual only ''to the extent that the expenses do not exceed the amount of expenses'' that are treated as compensation to the specified individual. A specified individual is any individual who is subject to the requirements of section 16(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78p(a)) with respect to the taxpayer, or who would be subject to those requirements if the taxpayer were an issuer of equity securities referred to in that section. Section 274(e)(2)(B).

Thus, in the case of a specified individual, the section 274(e)(2) and (9) disallowance exceptions apply only to the extent that a taxpayer treats as compensation to the specified individual an amount equal to or greater than the amount of deductible entertainment expenses allocable to entertainment provided to the specified individual. Expenses allocable to entertainment provided to the specified individual that the taxpayer does not treat as compensation to the specified individual are disallowed.

Explanation of Provisions and Summary of Comments

1. Definition of Entertainment

a. Distinction Between Entertainment and Other Personal Use

Notice 2005–45 references § 1.274–2(b)(1) in defining entertainment. Commentators suggested that the proposed regulations should provide additional guidance on the meaning of ''entertainment'' in order to assist taxpayers in delineating between entertainment use and ''nonentertainment'' personal use. The proposed regulations do not adopt these comments because these rules are addressed in the existing regulations at § 1.274–2(b)(1). Consistent with those regulations, entertainment does not include travel for reasons such as attending to business other than that of the employer, medical purposes, attending funerals, and participating in charitable activities.

b. Primary Purpose Test

Several commentators recommended that the proposed regulations adopt a purpose of the flight test that would characterize a flight as a business flight for all purposes if the primary purpose of the flight is business. Thus, under the recommendation, if the primary purpose of the flight were business, no amount would be disallowed for entertainment provided to specified individuals who are traveling for entertainment purposes. Conversely, if the primary purpose of the flight were entertainment, no amount would be allowed as an expense deduction with respect to individuals traveling for business. The proposed regulations do not adopt these comments. The IRS and Treasury Department believe that disregarding entertainment use by a specified individual would be contrary to Congressional intent in amending section 274(e)(2) to disallow expenses allocable to entertainment use of aircraft by specified individuals. Section 274(e)(2)(B) focuses on the recipient of the entertainment, amusement, or recreation, not the purpose of the employer providing the entertainment or the overall use of the aircraft.

c. Use of Aircraft for Bona Fide Security Purposes

Several commentators suggested that entertainment use by a specified individual of an aircraft should not be treated as entertainment within the meaning of section 274 or subject to section 274(e)(2)(B) if there is a business need to use the aircraft to provide security, pursuant to § 1.132–5(m). The proposed regulations do not adopt this comment. Section 1.132–5(m) merely computes the income inclusion for a fringe benefit. It reduces the income inclusion amount rather than eliminates it. It does not convert entertainment flights into business flights.

2. Definition of Expenses

a. Fixed Costs

To calculate the amount of expenses for entertainment use of an aircraft, Notice 2005–45 provides that taxpayers must take into account all of the expenses of maintaining and operating the aircraft. Commentators recommended that entertainment expenses should not include fixed costs such as depreciation. Commentators noted that the legislative history refers to ''aircraft operating costs'' and ''actual cost'' and interpreted this language to mean that costs should be limited to variable costs. H. Conf. Rept. 108–755 at 798. Some commentators have suggested that incremental costs are the only costs that should be disallowed.

The proposed regulations do not adopt these comments. Industry use of the term ''operating costs'' generally refers to all costs, fixed and variable, including depreciation claimed on the taxpayer's tax return. Therefore, the IRS and Treasury Department believe that the use of the term ''operating costs'' in the legislative history does not reflect Congressional intent to apply section 274(e)(2) to variable costs only. Moreover, the term ''aircraft operating costs'' in the legislative history is consistent with use of that term in *Sutherland Lumber*, in which it referred to fixed and variable costs for purposes of section 274(e)(2).

b. Depreciation

Commentators suggested that disallowing accelerated depreciation (including the additional first-year depreciation under, for example, sections 168(k), 1400L(b), and 1400N(d)) would result in excessive amounts disallowed in early years and is inconsistent with Congressional intent to provide incentives for purchasing aircraft. In response to these comments, the proposed regulations permit a taxpayer to elect to calculate depreciation on a straight-line basis over the class life of an aircraft for all of the taxpayer's aircraft for the current year and all future years when calculating the amount of disallowed expenses.

c. Aggregation of Aircraft

Notice 2005–45 permits taxpayers to calculate expenses separately for each aircraft or to aggregate the expenses of

aircraft of similar cost profiles. For example, the expenses of turboprop aircraft may be aggregated (but may not be aggregated with the expenses of a jet aircraft) and the expenses of a two-engine jet aircraft may be aggregated (but may not be aggregated with the expenses of a four-engine jet aircraft).

Commentators requested that the proposed regulations provide more details on the definition of cost profile. In response to these comments, the proposed regulations provide additional characteristics that define similar cost profiles. Specific comments are requested on the appropriateness of these characteristics in defining similar cost profiles and on other characteristics that may be useful in determining criteria for aggregating aircraft.

3. Allocation Methods

Notice 2005–45 provides an occupied seat hour or mile formula to allocate expenses to entertainment flights provided to specified individuals. The formula multiplies the hours or miles flown by an aircraft by the number of occupied seats. Then a taxpayer aggregates all fixed and variable expenses to determine the total expenses paid or incurred during the taxable year with respect to an aircraft (or aggregated aircraft) and divides the amount of total expenses by total occupied seat hours or miles to determine the cost per occupied seat hour or mile. Once a taxpayer determines this cost, the taxpayer uses the cost to determine the expenses allocable to each specified individual's entertainment flight.

Commentators expressed concern that this formula may not produce accurate results and is administratively burdensome. The proposed regulations retain the occupied seat hour or mile formula, which allows averaging of fixed and variable costs and yields a simple formula for determining the cost of one occupied seat hour or mile. It does not require a determination of whether a flight is for entertainment of specified individuals or other uses or an allocation of entertainment and other costs for a particular flight. Once the taxpayer determines the cost per occupied seat hour or mile, the disallowance calculation is relatively easy and results in a cost for each occupied seat hour or mile allocable to each entertainment flight taken by a specified individual.

Nevertheless, in response to commentators' concerns, the proposed regulations provide the option of allocating expenses on a flight-by-flight basis as an alternative to using the occupied seat mile or hour formula. Under the flight-by-flight method, a taxpayer may aggregate all expenses for the taxable year and divide the amount of total expenses by the number of flight hours or miles for the taxable year to determine the cost per hour or mile. The taxpayer allocates expenses to each flight by multiplying the number of miles or hours for the flight by the expense per hour or mile and allocates expenses for the flight to the passengers on the flight per capita.

4. Specified Individuals

Notice 2005–45 applies to entertainment use of an aircraft provided to a specified individual of a taxpayer by a party related to the taxpayer within the meaning of sections 267(b) or 707(b). The notice also defines a specified individual as the recipient of entertainment provided to a spouse or family member of the specified individual or to another person because of the person's relationship to the specified individual, cf. § 1.61–21(a)(4), and includes those entertainment flights within the potential disallowance of costs to the taxpayer. Commentators expressed concern that these provisions defined specified individual too broadly, exceeding the authority of the IRS and Treasury Department, and suggested that the definition be narrowed.

The proposed regulations do not adopt these comments. In the GOZA, Congress enacted technical corrections that clarify that the related party rules of sections 267(b) and 707(b) apply to section 274(e)(2). The IRS and Treasury Department conclude that Congress intended all entertainment flights to be subject to the section 274(e)(2) requirements. However, comments on how the regulations could define passengers aboard by virtue of a relationship with a specified individual are welcome. Finally, the proposed regulations define *officer* by reference to regulations at 17 CFR 240.16a–1(f) that implement section 16(a) of the Securities Exchange Act of 1934.

5. Other

a. Determination of Basis

The proposed regulations provide that, if an amount disallowed is allocable to depreciation, § 1.274–7 applies and the basis of the aircraft is not reduced for the amount of depreciation disallowed.

b. Allocation of Expenses Pro Rata

Numerous commentators inquired how taxpayers should allocate disallowed expenses between fixed and variable expenses. In response to these comments, the proposed regulations provide that the expense disallowance provisions apply to expenses on a pro rata basis.

c. Deadhead Flights

Notice 2005–45 provides that an aircraft returning empty from a flight after discharging passengers or traveling empty to pick up passengers (deadheading) is treated as having the same number and character of occupied seat hours or miles as the leg or legs of the trip on which passengers are aboard.

Commentators, citing confusion on the treatment of deadhead flights, have requested additional guidance, including safe harbors such as treating the empty flight as if it had the same composition as the prior or subsequent flight. The proposed regulations adopt these comments by providing more detail on how taxpayers should treat deadhead flights.

d. Leasing of Taxpayer Aircraft

Commentators requested guidance on the leasing of aircraft to unrelated third parties. In response to these requests, the proposed regulations provide guidance on the treatment of expenses allocable to taxpayers that charter their aircraft.

e. Aircraft as Entertainment Facilities

Notice 2005–45 addressed the treatment of expenses for the entertainment use of aircraft and did not address the effect of the amendment to section 274(e)(2) on the treatment of aircraft as entertainment facilities. Commentators asked how the entertainment facility disallowance under section 274(a)(1)(B) interacts with rules on aircraft used to provide specified individuals with entertainment.

Section 274(a)(1)(B) disallows all the expenses, direct and indirect, associated with the ownership and operation of an aircraft that is an entertainment facility, except for expenses for business travel and expenses that meet the exceptions of section 274(e). Thus, expenses for personal, nonentertainment travel (such as for medical purposes or attending funerals), as well as for entertainment travel, are disallowed, unless an exception such as 274(e)(2) applies.

The IRS and Treasury Department believe that Congress, in adding section 274(e)(2)(B), contemplated entertainment use of aircraft by specified individuals without specifically considering circumstances in which aircraft may be regarded as entertainment facilities. Therefore, these proposed regulations are limited to use of taxpayer-provided aircraft in

entertainment activities under section 274(a)(1)(A), and do not provide rules relating to the application of section 274(e)(2)(B) in circumstances under which aircraft may be regarded as entertainment facilities under section 274(a)(1)(B). Comments are requested on whether the IRS and Treasury Department should issue guidance on aircraft as entertainment facilities and the content of the guidance.

f. Fringe Benefit Consistency Rules

The proposed regulations relax the consistency rule of § 1.61–21(g)(14)(i) to permit taxpayers to value the entertainment use of aircraft by specified individuals under the fair market value rules of § 1.61–21(b), but continue to value flights for other employees and for specified individuals not traveling for entertainment using either the SIFL formula of § 1.61–21(g) or the general (fair market value) rule of § 1.61–21(b).

The proposed regulations preserve the consistency rule of § 1.61–21(g)(14)(i) with respect to particular groups of employees (specified and non-specified individuals) and with respect to non-entertainment flights. Thus, if an employer values the entertainment use of aircraft by one specified individual under the fair market value rules of § 1.61–21(b) in a calendar year, the employer must use the fair market value rules to value the entertainment use of aircraft by all specified individuals during that calendar year.

The existing consistency rules of § 1.61–21(g)(14)(i) continue to apply for valuing the entertainment use of aircraft for other employees (non-specified individuals) and for valuing the personal use of aircraft by specified individuals not traveling for entertainment purposes. Thus, if an employer values the personal use of aircraft by any other employee or the non-entertainment personal use of aircraft by any specified individual using the SIFL formula of § 1.61–21(g) in a calendar year, the employer must use the SIFL formula to value the personal use of aircraft by all other employees and the non-entertainment personal use of aircraft by all specified individuals during that calendar year. Similarly, if the employer values the personal use of aircraft by any other employee or the non-entertainment personal use of aircraft by any specified individual using the fair market value rules of § 1.61–21(b) in a calendar year, the employer must use the fair market value rules to value the personal use of aircraft by all other employees and the non-entertainment personal use of aircraft by all specified individuals during that calendar year.

g. Treatment as Compensation to Non-Specified Individuals

The proposed regulations clarify that in order for a taxpayer to meet the requirements of section 274(e)(2) for expenses treated as compensation, the taxpayer must include the proper amount as compensation to an employee on the taxpayer's return.

h. Section 162(m)

Notice 2005–45 provides that any amount for the entertainment use of an aircraft that is treated by the taxpayer as compensation to a specified individual who is also a covered employee is subject to section 162(m). Commentators disagreed with this conclusion. They opined that the deduction disallowance of section 274 relates to the expenses of the aircraft, not amounts treated as income to the employee, and that, under § 1.162–25T, the expenses associated with providing the aircraft are not deducted by the employer as compensation. Thus, according to the commentators, expenses treated as compensation for purposes of section 274(e)(2) should not be subject to the deduction limitation of section 162(m). However, the IRS and Treasury Department believe that the deduction limitation of section 162(m) applies to amounts treated as compensation for purposes of section 274(e)(2). The legislative history of section 162(m) provides that the deduction limitation of section 162(m) applies to all remuneration for services, including cash and the cash value of all remuneration (including benefits) paid in a medium other than cash regardless of whether the remuneration is deducted as compensation. H.R. Conf. Rep. No. 103–213 (1993) at 585 (993–3 CB 463). Any amount included in an employee's income for entertainment flights is remuneration for services and therefore is subject to section 162(m).

i. Entertainment Sold to Customers

Commentators requested clarification on whether section 274(e)(8), the exception to section 274(a) for entertainment sold to customers, applies to a taxpayer's expenses for providing an aircraft for the entertainment use of specified individuals. A commentator asserted that section 274(e)(8) excepts expenses of a flight from the section 274(a) disallowance to the extent a passenger pays full and fair consideration. The commentator suggested that expenses are excepted from the section 274(a) disallowance under section 274(e)(8) in three circumstances common in business aviation: (1) A lease of an aircraft without a pilot at a fair market value lease rate; (2) payment of a fair market value charter rate for an aircraft the taxpayer has enrolled under a charter certificate held by a charter company; and (3) payment of expenses allowed to be reimbursed in a time-sharing agreement under Federal Aviation Regulation 91.501(d), 14 CFR 91.501(d).

The proposed regulations do not address these issues, as rules implementing the section 274(e)(8) exception are provided in § 1.274–2(f)(2)(ix). Therefore, it is outside the scope of these proposed regulations on the exceptions under section 274(e)(2) and (9). As stated in § 1.274–2(f)(2)(ix), section 274(e)(8) applies only to taxpayers that are in the trade or business of providing entertainment to customers, and only to entertainment sold to customers. Therefore, the exception does not apply to expenses paid or incurred for entertainment provided to individuals by taxpayers that are not in the trade or business of providing entertainment.

j. Charter Rate Safe Harbor

As an alternative to determining actual expenses, the IRS and Treasury Department are considering whether the regulations should permit taxpayers to determine the amount of their expenses paid or incurred for entertainment flights by reference to charter rates. Under such a safe harbor, taxpayers could elect to treat as the amount of expenses for entertainment flights an undiscounted charter rate for each flight in lieu of calculating the actual expenses of each entertainment flight provided to specified individuals. Under the safe harbor, the undiscounted charter rate for the flight would be allocated to the individuals on the flight in lieu of the occupied seat or flight-by-flight allocation methods.

Under the charter rate method being considered, an undiscounted charter rate would be based on the amount that a person would pay in an arms-length transaction to charter the same or comparable aircraft for the same or comparable flight. A taxpayer would have to show that a charter rate used to value flights is a substantiated actual, published, undiscounted charter rate charged to the general public within 10 days before or after the taxpayer's flight by a qualified chartering company. A qualified chartering company would be a chartering company unrelated to the taxpayer (within the meaning of section 267(b) or 707(b)) that is in the trade or business of chartering aircraft and that operates and charters 10 or more aircraft

to the general public during the taxable year. Leaseback arrangements or rates charged for off-peak usage, aircraft downtime, or by employers to their employees would not qualify under the safe harbor. A qualified chartering company would not include a chartering company that charters any aircraft to or for the use of a person (or an employee of the person) that owns any aircraft used by the chartering company. If a taxpayer elects the safe harbor, the taxpayer would have to use it for all entertainment flights on all of the taxpayer's aircraft for the current and all subsequent taxable years unless the taxpayer makes a proper revocation.

The proposed regulations do not include the safe harbor. Nonetheless, comments are requested on whether such a safe harbor, or other safe harbors, should be adopted. Comments are also requested on the availability of substantiated actual, published, undiscounted charter rates charged to the general public by companies that meet the requirements of a qualified chartering company.

Taxpayers may not use a charter rate to determine expenses allocable to entertainment flights unless and until a rule is adopted in final regulations.

Proposed Effective Date

The regulations, as proposed, apply to any taxable year beginning on or after the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**. However, taxpayers may rely on the rules in these proposed regulations or those provided in Notice 2005–45 for taxable years beginning before the publication of the Treasury decision. If Notice 2005–45 and the proposed regulations include different rules for the same particular issue, then the taxpayer may rely on either the rule set forth in Notice 2005–45 or the rule set forth in the proposed regulations. However, if the proposed regulations include a rule that was not included in Notice 2005–45, taxpayers may not rely on the absence of a rule in Notice 2005–45 to apply a rule contrary to the proposed regulations.

Special Analyses

This notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations and, because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any electronic or written comments (a signed original and eight (8) copies) that are submitted timely to the IRS. The IRS and Treasury Department specifically request comments on the clarity of the proposed regulations and how they may be made easier to understand.

A public hearing has been scheduled for October 25, 2007, at 10 a.m., in the auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC. Due to building security procedures, visitors must enter through the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the **FOR FURTHER INFORMATION CONTACT** section of this preamble.

Drafting Information

The principal authors of these proposed regulations are Michael A. Nixon and Christian T. Wood of the Office of Associate Chief Counsel (Income Tax & Accounting) and Lynne A. Camillo of the Office of the Division Counsel/Associate Chief Counsel (Tax Exempt & Government Entities). However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, under the authority of 26 U.S.C. 7805, 26 CFR Part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding entries in numerical order to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.274–9 also issued under 26 U.S.C. 274(o).* * *

Section 1.274–10 also issued under 26 U.S.C. 274(o).* * *

Par. 2. Section 1.61–21 is amended by revising paragraph (g)(14)(i) and (ii) and adding paragraph (g)(14)(iii) to read as follows:

§ 1.61–21 Taxation of fringe benefits.

* * * * *

(g) * * *

(14) * * *

(i) *Use by employer.* Except as otherwise provided in paragraph (g)(13) or paragraph (g)(14)(iii) of this section or in § 1.132–5(m)(4), if the non-commercial flight valuation rule of this paragraph (g) is used by an employer to value any flight provided in a calendar year, the rule must be used to value all flights provided to all employees in the calendar year.

(ii) *Use by employee.* Except as otherwise provided in paragraph (g)(13) or (g)(14)(iii) of this section or in § 1.132–5(m)(4), if the non-commercial flight valuation rule of this paragraph (g) is used by an employee to value a flight provided by an employer in a calendar year, the rule must be used to value all flights provided to the employee by that employer in the calendar year.

(iii) *Exception for entertainment flights provided to specified individuals after October 22, 2004.* Notwithstanding the provisions of paragraph (g)(14)(i) of this section, an employer may use the general valuation rules of § 1.61–21(b) to value the entertainment use of an aircraft by a specified individual. An employer who uses the general valuation rules of § 1.61–21(b) to value any entertainment use of an aircraft by a specified individual in a calendar year must use the general valuation rules of § 1.61–21(b) to value all entertainment use of aircraft provided to all specified individuals during that calendar year.

(A) *Specified individuals defined.* For purposes of paragraph (g)(14)(iii) of this section, *specified individual* is defined in section 274(e)(2)(B) and § 1.274–9(b).

(B) *Entertainment defined.* For purposes of paragraph (g)(14)(iii) of this section, *entertainment* is defined in § 1.274–2(b)(1).

* * * * *

Par. 3. Section 1.274–9 is added to read as follows:

§ 1.274–9 Entertainment provided to specified individuals.

(a) *In general.* No deduction is allowed for expenses for entertainment provided to a specified individual (as defined in paragraph (b) of this section) except to the extent that the expenses do not exceed the amount of the expenses treated as compensation to the specified individual, as provided in section

274(e)(2)(B) and (9) and § 1.274–10. The amount disallowed is reduced by any amount that the specified individual reimburses a taxpayer for the entertainment.

(b) *Specified individual defined.* (1) A specified individual is an individual who is subject to section 16(a) of the Securities Act of 1934 with respect to the taxpayer, or an individual who would be subject to section 16(a) if the taxpayer were an issuer of equity securities referred to in that section. Thus, for example, a specified individual is an officer, director, or more than 10 percent owner of a corporation taxed under subchapter C or subchapter S, or a personal service corporation. A specified individual includes every individual who—

(i) Is the direct or indirect beneficial owner of more than 10 percent of any class of any registered equity (other than an exempted security);

(ii) Is a director or officer of the issuer of the security;

(iii) Would be the direct or indirect beneficial owner of more than 10 percent of any class of a registered security if the taxpayer were an issuer of equity securities; or

(iv) Is comparable to an officer or director of an issuer of equity securities.

(2) For partnership purposes, a specified individual includes any partner that holds more than a 10 percent equity interest in the partnership, or any general partner, officer, or managing partner of a partnership.

(3) For purposes of this section, *officer* has the same meaning as in 17 CFR § 240.16a–1(f).

(4) A specified individual includes a director or officer of a tax-exempt entity.

(5) A specified individual of a taxpayer includes a specified individual of a party related to the taxpayer within the meaning of section 267(b) or section 707(b).

(6) For purposes of section 274(a), a specified individual is treated as the recipient of entertainment provided to a spouse or family member of the specified individual or to another individual because of the relationship of the spouse, family member or other individual to the specified individual. Thus, expenses allocable to entertainment provided to the spouse, family member, or other individual are attributed to the specified individual for purposes of determining the amount of disallowed expenses.

(c) *Entertainment use of aircraft by specified individuals.* For rules relating to entertainment use of aircraft by specified individuals, see § 1.274–10.

(d) *Effective/applicability date.* This section applies to taxable years beginning after the date these regulations are published as final regulations in the **Federal Register**.

Par. 4. Section 1.274–10 is added to read as follows:

§ 1.274–10 Special rules for aircraft used for entertainment.

(a) *Use of an aircraft for entertainment*—(1) *In general.* Under section 274(a) and this section, no deduction otherwise allowable under chapter 1 is allowed for expenses for the use of a taxpayer-provided aircraft for entertainment, except as provided in paragraph (a)(2) of this section.

(2) *Exceptions*—(i) *In general.* Paragraph (a)(1) of this section does not apply to deductions for expenses for business entertainment air travel or to deductions for expenses that meet the exceptions of section 274(e), § 1.274–2(f), and this section.

(ii) *Expenses treated as compensation*—(A) *Employees.* Section 274(a), paragraphs (a) through (d) of § 1.274–2, and paragraph (a)(1) of this section, in accordance with section 274(e)(2), do not apply (in the case of specified individuals, as provided in paragraph (a)(2)(ii)(C) of this section), to expenses for entertainment air travel provided to employees to the extent that a taxpayer—

(*1*) Properly treats the expenses with respect to the recipient of entertainment as compensation to an employee under chapter 1 and as wages to the employee for purposes of chapter 24; and

(*2*) Includes the proper amount in the employee's income under § 1.61–21.

(B) *Persons who are not employees.* Section 274(a), paragraphs (a) through (e) of § 1.274–2, and paragraph (a)(1) of this section, in accordance with section 274(e)(9), do not apply (in the case of specified individuals, as provided in paragraph (a)(2)(ii)(C) of this section), to expenses for entertainment air travel provided to persons who are not employees to the extent the expenses are includible in the income of those persons. This exception does not apply to any amount paid or incurred by the taxpayer that is required to be included in any information return filed by the taxpayer under part III of subchapter A of chapter 61 and is not so included.

(C) *Specified individuals.* Section 274(a) and paragraphs (a) through (d) of § 1.274–2, in accordance with section 274(e)(2)(B), do not apply to expenses for entertainment air travel of a specified individual to the extent that the expenses do not exceed the sum of—

(*1*) The amount treated as compensation under paragraph (a)(2)(ii)(A) of this section or reported as income under paragraph (a)(2)(ii)(B) of this section to the specified individual; and

(*2*) Any amount the specified individual reimburses the taxpayer.

(b) *Definitions.* The definitions in this paragraph (b) apply for purposes of this section.

(1) *Entertainment.* For the definition of entertainment for purposes of this section, see § 1.274–2(b)(1). Entertainment does not include personal travel that is not for entertainment purposes. For example, travel to attend a family member's funeral is not entertainment.

(2) *Entertainment air travel.* Entertainment air travel is any travel aboard a taxpayer-provided aircraft for entertainment purposes.

(3) *Business entertainment air travel.* Business entertainment air travel is any entertainment air travel aboard a taxpayer-provided aircraft that is directly related to the active conduct of the taxpayer's trade or business or related to an expenditure directly preceding or following a substantial and bona fide business discussion and associated with the active conduct of the taxpayer's trade or business. See § 1.274–2(a)(1)(i) and (ii). Air travel is not business entertainment air travel merely because a taxpayer-provided aircraft is used for the travel as a result of a bona fide security concern under § 1.132–5(m).

(4) *Taxpayer-provided aircraft.* A taxpayer-provided aircraft is any aircraft owned by, leased to, or chartered to, a taxpayer or any party related to the taxpayer (within the meaning of section 267(b) or section 707(b)).

(5) *Specified individual.* For rules relating to the definition of a specified individual, see § 1.274–9.

(c) *Amount disallowed.* The amount disallowed under this section for an entertainment flight by a specified individual is the amount of expenses allocable to the entertainment flight of the specified individual under paragraph (e)(2)(ii)(D), (e)(3)(ii), or (f)(3) of this section, reduced (but not below zero) by the amount the taxpayer treats as compensation under paragraph (a)(2)(ii)(A) of this section or reports as income under paragraph (a)(2)(ii)(B) of this section to the specified individual, plus any amount the specified individual reimburses the taxpayer.

(d) *Expenses taken into account under this section*—(1) *Definition of expenses.* In determining the amount of expenses taken into account under this section, a taxpayer must take into account all of the expenses of operating the aircraft, including all fixed and

variable expenses the taxpayer deducts in the taxable year. These expenses include, but are not limited to, salaries for pilots, maintenance personnel, and other personnel assigned to the aircraft; meal and lodging expenses of flight personnel; take-off and landing fees; costs for maintenance flights; costs of on-board refreshments, amenities and gifts; hangar fees (at home or away); management fees; costs of fuel, tires, maintenance, insurance, registration, certificate of title, inspection, and depreciation; and all costs paid or incurred for aircraft leased, or chartered, to or by the taxpayer.

(2) *Leases or charters to third parties.* Expenses allocable to a lease or charter of a taxpayer's aircraft to an unrelated third-party in a bona-fide business transaction for adequate and full consideration are not taken into account for purposes of the definition of expenses in paragraph (d)(1) of this section. Only expenses allocable to the charter period are not taken into account under this paragraph (d)(2).

(3) *Straight-line method permitted for determining depreciation disallowance under this section*—(i) *In general.* In lieu of the amount of depreciation deducted in the taxable year, solely for purposes of paragraph (d)(1) of this section, a taxpayer may elect to treat as its depreciation deduction the amount that would result from using the straight-line method of depreciation over the class life (as defined by section 168(g)(2) and taking into account the applicable convention under section 168(d)) of an aircraft, although the taxpayer uses another methodology to calculate depreciation for the aircraft under other sections of the Internal Revenue Code (for example, section 168). If the property is qualified property or 50-percent bonus depreciation property under section 168(k), qualified New York Liberty Zone property under section 1400L(b), or qualified Gulf Opportunity Zone property under section 1400N(d), depreciation for purposes of this straight-line election is determined on the unadjusted depreciable basis of the property. For purposes of this section, a taxpayer that elects to use the straight-line method and class life under this paragraph (d)(3) for any aircraft it operates must use that method for all taxpayer-provided aircraft it operates and must continue to use the method for the entire period the taxpayer uses any taxpayer-provided aircraft.

(ii) *Aircraft placed in service in earlier taxable years.* If the taxpayer elects to use this paragraph (d)(3) with respect to aircraft placed in service in taxable years before the current taxable year, the amount of depreciation is determined by applying the straight-line method of depreciation to the original cost (or, for property acquired in an exchange to which section 1031 applies, the basis of the aircraft as determined under section 1031(d)) and over the class life (taking into account the applicable convention under section 168(d)) of the aircraft as though the taxpayer used that methodology from the year the aircraft was placed in service.

(iii) *Manner of making and revoking election.* A taxpayer makes the election under this paragraph (d)(3) by filing an income tax return for the taxable year that determines the taxpayer's expenses for purposes of paragraph (d)(1) of this section by including depreciation as determined under this paragraph (d)(3). An election may be revoked only for compelling circumstances upon consent of the Commissioner by private letter ruling.

(4) *Aggregation of aircraft*—(i) *In general.* A taxpayer may aggregate the expenses of aircraft of similar cost profiles for purposes of calculating disallowed expenses under paragraph (c) of this section.

(ii) *Similar cost profiles.* Aircraft are of similar cost profiles if their operating costs per mile or per hour of flight are comparable. Aircraft must have the same engine type (jet or propeller) and the same number of engines to have similar cost profiles. Other factors to be considered in determining whether aircraft have similar cost profiles include, but are not limited to, payload, passenger capacity, fuel consumption rate, age, maintenance costs, and depreciable basis.

(e) *Allocation of expenses*—(1) *General rule.* Except as provided in paragraph (f)(4) of this section, for purposes of determining the expenses allocated to entertainment air travel of a specified individual under paragraph (a)(2)(ii)(C) of this section, a taxpayer must use either the occupied seat hours or miles method of paragraph (e)(2) of this section or the flight-by-flight method of paragraph (e)(3) of this section. A taxpayer must use the chosen method for all flights of all aircraft for the taxable year.

(2) *Occupied seat hours or miles method*—(i) *In general.* The occupied seat hours or miles method determines the amount of expenses allocated to a particular entertainment flight of a specified individual based on the occupied seat hours or miles for an aircraft for the taxable year. Under this method, a taxpayer may choose to use either occupied seat hours or miles for the taxable year to determine the amount of expenses allocated to entertainment flights of specified individuals, but must use occupied seat hours or miles consistently for all flights for the taxable year.

(ii) *Computation of the occupied seat hours or miles method.* The amount of expenses allocated to an entertainment flight taken by a specified individual is determined under the occupied seat hours or miles method by—

(A) Determining the total expenses for the year under paragraph (d)(1) of this section for the aircraft or group of aircraft (as determined under paragraph (d)(4) of this section), as applicable;

(B) Determining the total number of occupied seat hours or miles for the taxable year for the aircraft or group of aircraft by totaling the occupied seat hours or miles of all flights in the taxable year flown by the aircraft or group of aircraft, as applicable. The occupied seat hours or miles for a flight is the number of hours or miles flown for the flight multiplied by the number of seats occupied on that flight. For example, a flight of six hours with three passengers results in 18 occupied seat hours;

(C) Determining the cost per occupied seat hour or mile for the aircraft or group of aircraft, as applicable, by dividing the total expenses in paragraph (e)(2)(ii)(A) of this section by the total number of occupied seat hours or miles determined in paragraph (e)(2)(ii)(B) of this section; and

(D) Determining the amount of expenses allocated to an entertainment flight taken by a specified individual by multiplying the number of hours or miles of the flight by the cost per occupied hour or mile for that aircraft or group of aircraft, as applicable, as determined in paragraph (e)(2)(ii)(C) of this section.

(iii) *Allocation of expenses of multi-leg trips involving both business and entertainment legs.* A taxpayer that uses the occupied seat hours or miles allocation method must allocate the expenses of a trip by a specified individual that involves at least one segment for business and one segment for entertainment purposes between the business travel and the entertainment travel unless none of the expenses for the entertainment segment are disallowed. The entertainment cost of a multi-leg trip is the total cost of the flights (by occupied seat hours or miles) over the cost of the flights that would have been taken without the entertainment segment or segments.

(iv) *Examples.* The following examples illustrate the provisions of this paragraph (e)(2):

Example 1. (i) A taxpayer-provided aircraft is used for Flights 1, 2, and 3, of 5 hours, 5

hours, and 4 hours, respectively, during the Taxpayer's taxable year. On Flight 1, there are four passengers, none of whom are specified individuals. On Flight 2, passengers A and B are specified individuals traveling for entertainment purposes and passengers C and D are not specified individuals. Taxpayer treats $1,200 as compensation to A, and B reimburses Taxpayer $500. On Flight 3, all four passengers (A, B, E, and F) are specified individuals traveling for entertainment purposes. The Taxpayer treats $1,300 each as compensation to A, B, E, and F. Taxpayer incurs $56,000 in expenses for the operation of the aircraft for the taxable year. The aircraft is operated for 56 occupied seat hours for the period (four passengers times 5 hours or 20 occupied seat hours for Flight 1, plus four passengers times 5 hours or 20 occupied seat hours for Flight 2, plus four passengers times 4 hours or 16 occupied seat hours for Flight 3). The cost per occupied seat hour is $1,000 ($56,000/56 hours).

(ii) For purposes of determining the amount disallowed (to the extent not treated as compensation or reimbursed), $5,000 ($1,000 × 5 hours) each is allocable with respect to A and B for Flight 2, and $4,000 ($1,000 × 4 hours) each is allocable with respect to A, B, E, and F for Flight 3.

(iii) For Flight 2, because Taxpayer treats $1,200 as compensation to A, and B reimburses Taxpayer $500, Taxpayer may deduct $1,700 of the cost of Flight 2 allocable to A and B. The deduction for the remaining $8,300 cost allocable to entertainment provided to A and B on Flight 2 is disallowed (with respect to A, $5,000 less the $1,200 treated as compensation, and with respect to B, $5,000 less the $500 reimbursed).

(iv) For Flight 3, because Taxpayer treats $1,300 each as compensation to A, B, E, and F, Taxpayer may deduct $5,200 of the cost of Flight 3. The deduction for the remaining $10,800 cost allocable to entertainment provided to A, B, E, and F on Flight 3 is disallowed ($4,000 less the $1,300 treated as compensation to each specified individual).

Example 2. (i) G, a specified individual, is the sole passenger on an aircraft on a two-hour flight from City A to City B for business purposes. G then travels on a three-hour flight from City B to City C for entertainment purposes, and returns from City C to City A on a four-hour flight. G's flights have resulted in nine occupied seat hours (two for the first segment, plus three for the second segment, plus four for the third segment). If G had returned directly to City A from City B, the flights would have resulted in four occupied seat hours.

(ii) Under paragraph (e)(2)(iii) of this section, five occupied seat hours are allocable with respect to G's entertainment (nine total occupied seat hours minus the four occupied seat miles that would have resulted if the travel had been a roundtrip business trip without the entertainment segment). If Taxpayer's cost per occupied seat hour for the year is $1,000, $5,000 is allocated with respect to G's entertainment use of the aircraft ($1,000 × five occupied seat hours). The amount disallowed is $5,000 minus any amount the Taxpayer treats as compensation to G or that G reimburses Taxpayer.

(3) *Flight-by-flight method*—(i) *In general.* The flight-by-flight method determines the amount of expenses allocated to a particular entertainment flight of a specified individual on a flight-by-flight basis by allocating expenses to individual flights and then to a specified individual traveling for entertainment purposes on that flight.

(ii) *Allocation of expenses.* A taxpayer using the flight-by-flight method must aggregate all expenses (as defined in paragraph (d)(1) of this section) for the taxable year for the aircraft or group of aircraft (as determined under paragraph (d)(4) of this section), as applicable, and divide the total amount of expenses by the number of flight hours or miles for the taxable year for that aircraft or group of aircraft, as applicable, to determine the cost per hour or mile. Expenses are allocated to each flight by multiplying the number of miles or hours for the flight by the cost per hour or mile. The expenses for the flight are then allocated to the passengers on the flight per capita. Thus, if three of five passengers are traveling for business and two passengers are specified individuals traveling for entertainment purposes, and the total expense allocated to the flight is $10,000, the expense allocable to each specified individual is $2,000.

(f) *Special rules*—(1) *Determination of basis.* If an amount disallowed is allocable to depreciation under paragraph (f)(2) of this section, the rules of § 1.274–7 apply. In that case, the basis of an aircraft is not reduced for the amount of depreciation disallowed under this section.

(2) *Pro rata disallowance.* The expense disallowance provisions of this section are applied on a pro rata basis to all of the expenses disallowed by this section.

(3) *Deadhead flights.* (i) For purposes of this section, an aircraft returning without passengers after discharging passengers or flying without passengers to pick up passengers (deadheading) is treated as having the same number and character of passengers as the leg of the trip on which passengers are aboard for purposes of the allocation of expenses under paragraphs (e)(2) or (e)(3) of this section. For example, when an aircraft travels from point A to point B and then back to point A, and one of the legs is a deadhead flight, for determination of disallowed expenses, the aircraft is treated as having made both legs of the trip with the same passengers aboard for the same purposes.

(ii) When a deadhead flight does not occur within a roundtrip flight, but occurs between two unrelated flights involving more than two destinations (such as an occupied flight from point A to point B, followed by a deadhead flight from point B to point C, and then an occupied flight from point C to point A), the allocation of passengers and expenses to the deadhead flight occurring between the two occupied trips is based on the number of passengers on board for the two occupied legs of the flight, the character of the passengers on board (entertainment or nonentertainment purpose) and the length in hours or miles of the two occupied legs of the flight.

(g) *Effective/applicability date.* This section applies to taxable years beginning after the date these regulations are published as final regulations in the **Federal Register**.

Kevin M. Brown,

Deputy Commissioner for Services and Enforcement.

[FR Doc. E7–11445 Filed 6–14–07; 8:45 am]

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DEPARTMENT OF THE INTERIOR

Office of Surface Mining Reclamation and Enforcement

30 CFR Part 917

[KY–251–FOR]

Kentucky Abandoned Mine Land Reclamation (AMLR) Plan

AGENCY: Office of Surface Mining Reclamation and Enforcement (OSM), Interior.

ACTION: Proposed rule; public comment period and opportunity for public hearing on proposed amendment.

SUMMARY: We are announcing receipt of a proposed amendment to the Kentucky Abandoned Mine Land Reclamation (AMLR) Plan under the Surface Mining Control and Reclamation Act of 1977 (SMCRA or the Act). The amendment makes several revisions to Kentucky's AMLR Plan and is intended to update and improve the effectiveness of the AMLR plan. Kentucky submitted the amendment in response to the passage of the Surface Mining Control and Reclamation Act Amendments of 2006. This document gives the times and locations that the Kentucky program and this submittal are available for your inspection, the comment period during which you may submit written comments, and the procedures that we will follow for the public hearing, if one is requested.

DATES: We will accept written comments until 4 p.m., e.s.t., July 16, 2007. If requested, we will hold a public